APPENDIX.

Statutes and Regulations Involved.

Section 22(c) of the Revenue Act of 1934 reads as follows:

> "(c) *Inventories.* Whenever in the opinion of the Commissioner the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer upon such basis as the Commissioner, with the approval of the Secretary, may prescribe as conforming, as nearly as may be, to the best accounting practice in the trade or business and as most clearly reflecting the income."

Section 113(a) (1) of the Revenue Act of 1934 reads as follows:

> "113. *Adjusted Basis for Determining Gain or Loss.*
> "(a) *Basis (Unadjusted) of Property.* The basis of property shall be the cost of such property; except that—
> "(1) *Inventory value.* If the property should have been included in the last inventory, the basis shall be the last inventory value thereof."

Section 113(a)(11) of the Revenue Act of 1934 reads as follows:

> "(11) *Property acquired during affiliation.* In the case of property acquired by a corporation, during a period of affiliation, from a corporation with which it was affiliated, the basis of such property, after such period of affiliation, shall be determined, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, without regard to intercompany transactions in respect of which gain or loss was not recognized. For the purposes of this paragraph, the term 'period of affiliation' means the period during which such corporations were affiliated (determined in accordance with the law applicable thereto) but does not include any taxable year beginning on or after January 1, 1922, unless a consolidated return was made, nor any taxable year after the taxable year 1928.

> The basis in case of property acquired by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under Section 141 of this Act or the Revenue Act of 1928 or the Revenue Act of 1932, shall be determined in accordance with regulations prescribed under Section 141(b) of this Act or the Revenue Act of 1928 or the Revenue Act of 1932. The basis in the case of property held by a corporation during any period, in the taxable year 1929 or any subsequent taxable year, in respect of which a consolidated return is made by such corporation under Section 141 of this Act or the Revenue Act of 1928 or the Revenue Act of 1932, shall be adjusted in respect of any items relating to such period, in accordance with regulations prescribed under Section 141(b) of this Act or the Revenue Act of 1928 or the Revenue Act of 1932, applicable to such period."

A portion of Article 113(a)(11)-1 of Regulations 86 relating to the income tax under the Revenue Act of 1934 reads as follows:

> "* * * The basis of property after a consolidated return period shall be the same as immediately prior to the close of such period. This rule is applicable, for instance, to the making of separate returns by the members of an affiliated group of corporations for taxable years beginning after December 31, 1933, due to the withdrawal under the law of the privilege of making consolidated returns. For example, if a corporation has been a member of an affiliated group which has made a consolidated return on the calendar year basis for the taxable year 1933 and is required to make a separate return for the taxable year 1934 and succeeding taxable years, the value of the opening inventory to be used in computing such corporation's net income for the taxable year 1934 is the proper value of the closing inventory used in computing the consolidated net income for the preceding taxable year."

Reg. 86, Art. 22(c)-2, *Valuation of inventories.*— Section 22(c) provides two tests to which each inventory must conform:

(1) It must conform as nearly as may be to the best accounting practice in the trade or business, and

(2) It must clearly reflect the income.

It follows, therefore, that inventory rules cannot be uniform but must give effect to trade customs which come within the scope of the best accounting practice in the particular trade or business. In order clearly to reflect the income, the inventory practice of a taxpayer should be consistent from year to year, and greater weight is to be given to consistency than to any particular method of inventorying or basis of valuation so long as the method or basis used is substantially in accord with these regulations. An inventory that can be used under the best accounting practice in a balance sheet showing the financial position of the taxpayer can, as a general rule, be regarded as clearly reflecting his income.